

December 22, 2003

TO: State Payroll Supervisors

FROM: Brian Berghoff, Department of Retirement Systems
Millie Lund, Office of Financial Management

**SUBJECT: Workmen's Compensation Temporary Duty Disability
Optional Retirement Service Credit for Unpaid Leave**

This memorandum clarifies information on a member's option to purchase lost service credit due to being temporarily disabled in connection with their job. The result requires an update to the state of Washington's *State Administrative and Accounting Manual* (SAAM), issued by the Office of Financial Management (OFM). The SAAM change in Subsection 25.40.40.d (Worker's Compensation) is effective immediately on a prospective basis only. A draft copy of that change is attached.

Employees who are on unpaid leave, or who choose to be on unpaid leave while receiving workers' compensation benefits under Chapter 51 RCW, must consider if they wish to purchase retirement service credit during the period of the temporary disability or if they want to defer that decision indefinitely.

Employee Option to Purchase Service Credit While on Disability

In accordance with DRS Notice 94-006, which is located on the DRS website at <http://www.drs.wa.gov/employer/drsn/drsn1994/94006.pdf>, members of PERS Plan 1, 2 and 3 may purchase up to 12 months of lost service credit based on the regular compensation that would have been paid if the temporary disability had not occurred. For LEOFF Plan 2 and State Patrol Plans 1 & 2, call DRS. The two employee options per Notice 94-006 and associated considerations are:

- 1. The employer and employee agree (written agreement recommended) to continue to make full contributions on the member's regular compensation for up to twelve months unless the disability leave ends sooner or the member separates from service.**

The employer/employee contributions must be paid and reported to DRS on the regular transmittal report just as they would be if the employee were working full time. This can occur if: (A) the employee provides the agency the contribution amounts on an "as you go" (i.e., payment plan) basis or (B) the agency chooses to pay the employee's contributions in advance to be reimbursed later. For this choice, recovery of the employee's share is between the agency and the employee.

Any question regarding the legality for an agency to pay the employee's contributions on an interim basis should be directed to the agency's assistant attorney general.

The procedures to use Option #1 must include the following considerations:

Agencies must have agreements in place quickly after the time loss occurs so as to keep forwarding employee/employer retirement contributions on a timely semi-monthly basis. This means the employee must be made aware of his/her options (regarding how lost service credit can be purchased) as quickly as possible after a time loss incident so the employee can make a decision between Option #1 or Option # 2.

Agencies are not required to accommodate an employee's request to continue to forward ongoing retirement contributions but if the agency is willing to do this, the agency would need to decide: (A) if they will want to do this only if the employee provides the employee contributions according to the semi-monthly time lines or (B) if the agency will be willing to set up an accounts receivable and pay for the employee's contribution on a temporary basis to be reimbursed by the employee on an agreed payment basis.

Per DRS, the employee contributions will be considered tax deferred (like all other member contributions reported via the transmittal) per RCW 41.04.455.

Choosing Option #1 will avoid interest charges assessed by DRS to the employee and the employer when option #2 is selected. The current interest rate is 8 percent-compounded monthly.

Payroll Processes Required for Option #1:

Employee Contributions Deducted via the Payroll System

If the employee should happen to have any payroll to process and pay such as regular time or paid leave, then this would provide an opportunity and preferable to set up a miscellaneous tax deferred retirement deduction to provide DRS the *additional contributions necessary to cover the unpaid leave purchased service credit*. Check with the payroll system being utilized to determine if use of an additional miscellaneous tax deferred employee retirement contribution will also generate the employer's contribution. If the system does not do this, then the agency will have to manually charge and provide DRS the employer's contribution along with the warrant or check for the employee's contribution.

Using an additional miscellaneous deduction allows the payroll system's *standard* tax deferred retirement deduction to continue to take contributions on the paid time or leave and also generate the employer's contribution as well for that standard deduction.

Manual Receipt of Employee Retirement Contributions

If the employee contributions are either manually provided by the employee or paid for in advance by the agency, a YTD manual adjustment must be entered in the applicable payroll system in the Tax Deferred Retirement Employee Contributions field to increase the contributions by the amount(s) that are provided outside the payroll system. This will then correctly report the total calendar year employee's tax deferred retirement contributions for W-2 reporting by reducing Taxable Gross Compensation in Box 1 and increasing the tax deferred retirement contributions in Box 14 A (HRISD payroll system).

Any temporary agency payment of the employee's contributions should be charged to a receivable to be collected per agreement from the employee. The appropriate employer's contributions will need to be charged to expenditures, sub object BB and forwarded along with the employee's contributions to DRS.

2. **The employee contacts DRS directly following an authorized leave for disability and requests to purchase the lost service credit. DRS will bill the employee their contributions plus interest (compounded monthly). Employers are billed their contributions plus interest (compounded monthly) only if and when the member makes payment in full on this optional bill.**

The procedures to use this method must include the following considerations:

As with Option #1, the employee must be made aware of the possible options for purchasing service credit for unpaid leave as soon as possible after a time loss incident. Inform the employee to decide as soon as possible if purchase of the unpaid leave is wanted to avoid interest charges.

Use of Option #2 will remain a decision for the employee who must contact DRS directly to request the service credit purchase. An employee is not required to make this option nor is there any specific time period requirement to make the decision. However, the longer the employee waits, the larger the interest amount will be.

DRS will provide a billing both for the employee and employer but the employer will not be billed until the employee has paid to DRS the entire bill (employee contributions plus interest billing.) Interest of 8% compounded monthly will be charged to both the employee and employer. The interest percentage is based on the authority of the DRS Director and is intended to cover the lost investment earnings to the Trust Funds.

Agencies should not report employee contributions billed by DRS on the retirement transmittal. An agency could accept an employee's request to take extra deductions to help facilitate installment payments to DRS. Per DRS, these extra deductions have to be taxed retirement deductions done through payroll if the agency opts to honor such a request. The employee contributions sent to DRS must be attached to a copy of the pay stub (attached to bottom of the employee's

optional bill) and has to be a separate payment from the normal payment transmissions to DRS.

The agency will get a DRS invoice (for the employer contributions and interest) associated with the lost service credit purchase only after the employee pays their optional bill in full.

There are no federal reporting requirements on IRS Forms W2 for taxed retirement deductions.

Additional DRS Reporting Adjustment Required For Any Sick Leave Buy Back

After restoring any sick leave buyback hours, complete the following process **only if Option # 1 above was not chosen**. Option #1 is no longer an option if an agreement between the employer and employee is not completed by the first pay period (when the employee is receiving workers' compensation benefits) that includes leave without pay.

Send DRS a corresponding negative adjustment to the compensation, retirement contributions and hours for the associated earning period(s) based on the restoration of sick leave. Keep in mind tax deferred retirement contributions would have been deducted on the original paid sick leave during the disability period so the partial reversal must adjust the employee's tax deferred contributions.

For example:

Employee on worker's compensation opted to use 10 hours sick leave while on time loss temporary disability. Retirement contributions will have been taken on the 10 hours of sick leave. At that time, there is no way to know what L&I time loss payments may be made to the employee by Labor & Industries (L&I) so any calculation by the agency of the \$ value of the sick leave buyback and sick leave restoration cannot be made till later. The adjustment has to be done after the L&I Payment Notice is received, any sick leave taken is substantiated, sick leave buyback is calculated, \$ recovered, and the number of sick leave hours restored.

The agency calculates the sick leave buyback \$ amount to be recovered and this amounts to 4 hours of sick leave to restore when the \$ are paid back. The net sick leave that should actually have retirement contributions taken on is 6 hours.

If the employee is still on payroll at the time the retirement adjustment is to be made, the agency should contact the respective payroll system used to get advice on how to refund the employee's appropriate tax deferred contributions back through the payroll process. This way the tax deferred nature of the original deduction and adjustment are both handled in the same manner. It may be that using a tax deferred retirement contribution *miscellaneous deduction code* to refund a portion of the previously deducted tax deferred retirement is preferable than attempting to "net" one standard deduction adjustment of the current payroll' standard retirement deduction less the refund amount.*

If the employee is still on the payroll, and the refund is for an employee's prior calendar year's tax deferred retirement contributions, a separate tax deferred retirement deduction should also be able to be done to refund a tax deferred contribution for return of the prior

*years' contributions because we believe the receipt of the prior year(s) tax deferred retirement contributions is a current year taxable reportable item**. Do not change the regular tax deferred deduction indicator. The separate tax deferred retirement refund entry will increase taxable compensation on the current calendar year's Form W-2, Box 1 and decrease reported tax deferred retirement contributions for the year.

*Warning: Coding refunds (negative separate taxed contributions) in the payroll system may result in additional accounting, particularly in the HRISD payroll system.

In the HRISD system, a *net* negative tax deferred retirement entry for a payroll will currently cause a receivable in the agency's payroll revolving fund, GL1319. Though the employee would get the refund through the payroll process, the payroll revolving fund would need to be reimbursed by returned \$ from DRS for the employee's contribution. Usually the agency would prepare a journal voucher to obtain both the employee and employer's contributions from DRS. The employer's returned contribution would be credited to expenditures, sub object BB, regardless of which appropriation year was involved. OFM policy notes worker's compensation recoveries are to be credited to current expenditures.

Submission of the negative member and employer contributions on the retirement transmittal reduces the employer's current receivable due to DRS. For the payroll transactions provided above, the agency can use a journal voucher to submit to DRS to get the dollars back. Another alternative an agency might consider, depending on possible other payroll refund transaction methods utilized, an agency could use the DRS credit redistribution process to move the credit forward one month and short their next month's payment. Contact DRS for further information on this process.

If the employee is no longer on the payroll or the restoration is being done in a future calendar year, again, we believe the return of tax deferred employee contributions is to be reported as a taxable item on a W2 for the current calendar year in which the refund is received. If the employee is terminated, then a manual IRS Form W2 would need to be prepared and provided to the employee along with the returned employee contributions. The Form W2 must include the gross amount refunded the employee in Box 1.

When both the employee and employer contributions are returned from DRS, return the refund to the ex employee and record the employer's refund of contributions as a credit to current appropriation expenditures in sub object BB.

Prospective Retirement Adjustments

As stated above, the change to the SAAM manual with regard to retirement adjustments (when sick leave is restored and only Option #2 is available) described above are prospective only.

If you have any questions related to what needs to be reported to DRS, contact Employer Support Services via drsemployer@drs.wa.gov or call (360) 664-7200, select option 2 or 1-800-547-6657, select option 6 and option 2. In addition, direct any questions pertaining to the tax treatment of the employer retirement contributions to DRS.

If you have any questions related to how to use your payroll system to complete the transactions discussed in this document, contact the appropriate payroll system Help Desk.

Any questions regarding accounting entries should be directed to your OFM agency designated accounting consultant.

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